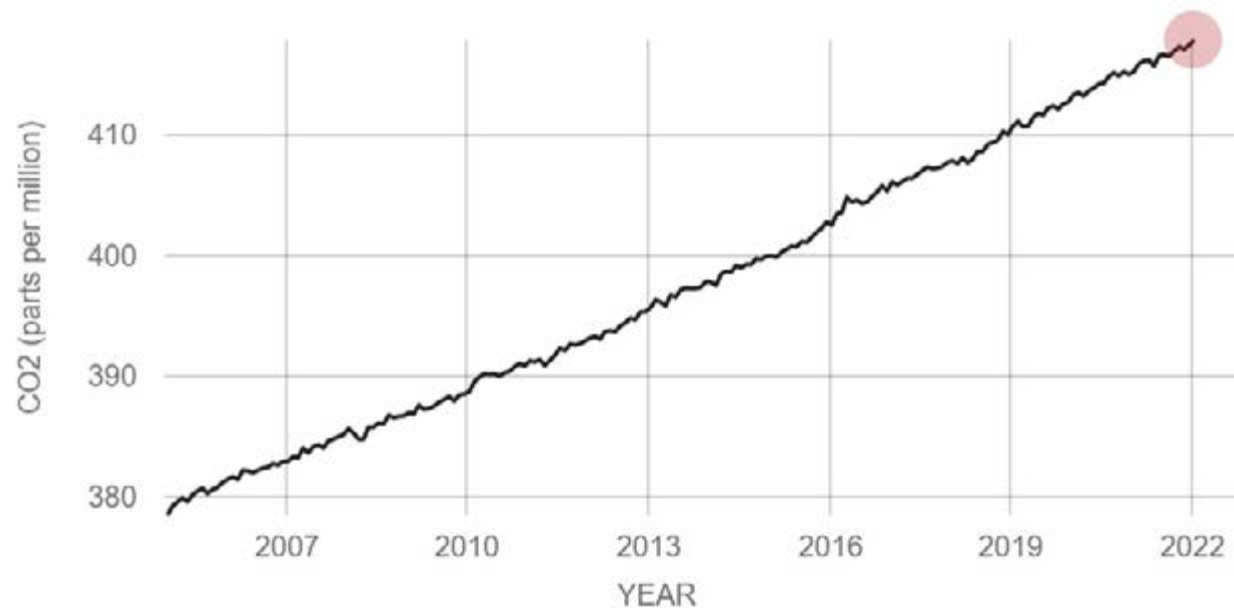

VALUE PROPOSITION

Latin American and
Caribbean Initiative for the
Development of the Carbon
Market (ILACC)

THE BACKGROUND AND OBJECTIVE

DIRECT MEASUREMENTS: 2005-PRESENT

Data source: Monthly measurements (average seasonal cycle removed). Credit: [NOAA](#)



- There is a global challenge to reduce global warming by avoiding an increase of 2.0 degrees above pre-industrial levels.
- Reaching these levels requires global GHG emission to be reduced by 50% from current levels by 2030 and net-zero emissions to be achieved by 2050.



In the region, Argentina, Chile, Colombia, and Mexico are pioneers in the implementation of carbon pricing instruments (CPI), with four federal taxes, three subnational taxes, and a national emissions trading system.

Of the issues discussed at COP26, one of the ones that should draw the most attention from the region is the carbon market. This is because Latin America and the Caribbean could position itself, according to international experts, among the world's leading providers of carbon credits, mainly when considering the potential to offer carbon credits¹ from nature-based solutions (NBS), such as those from forest removal and emissions avoided by preventing deforestation.

At the end of COP26 and the approval of the basic manual of article 6 of the Paris Agreement, there will probably be a kind of "race" between countries and between different companies, banks, funds, consultants and others to occupy spaces in this multi-million dollar market – energy consultancy Wood Mackenzie estimates the carbon market to be worth \$22 trillion by 2050. Figuratively speaking, there will be a kind of "Gold Rush," as in the American Wild West paradigm. Although the approval of the basic manual will help order the formation of markets and the formation of prices, there will still be many gray areas that will give way to speculation, until the subject lands later. The World Bank notes that there are currently 64 carbon pricing instruments in force or in the process of being implemented in the world in the form of markets or other mediums.

The main incentive for this market to advance is the price per ton of carbon, which in recent years has been around USD 0.5 to USD 5 and has proven to be very volatile due to the still incipient stage of organization

of this market. However, experts predict that as the market continues to reorganize, the values will reach between USD 75 and USD 100, which would be the necessary price point for the world to reduce emissions, as is required to achieve carbon neutrality in 2050.

In the region, Argentina, Chile, Colombia, and Mexico are pioneers in the implementation of carbon pricing instruments (CPI), with four federal taxes, three subnational taxes, and a national emissions trading system. These four countries implemented their CPIs as part of broader structural (fiscal) reforms. The search for the development of market cooperation by Latin American countries, such as the Pacific Alliance, is also observed.

The markets were already anticipating the approval of COP26 and were already accelerating the carbon credit business. In 2021, the voluntary carbon market reached a record value, surpassing the billion dollar mark, at an average price (from January to November) about 35% higher than the previous year. In fact, a large number of countries, provinces and even cities have already been and continue to enter this market and are passing the relevant legislation. In addition, the demand for carbon credits for compliance obligations is also expected to grow in the coming years, in the context of both sectoral agreements, such as CORSIA, as well as national regulations and also international commitments, especially under Article 6 of the Paris Agreement.

But, based on the experience of the financial, capital and

¹ In 2020, Latin America reached nearly 40% of the market-share, leading the global offer of carbon credits in the voluntary market through NBS projects.



The objective of the Latin America and the Caribbean Carbon Market Initiative (ILACC) is to promote the global competitiveness of the supply of carbon credits generated in the region, expanding the impacts on job creation, income, development of value chains, technologies, clusters, green business products and the fight against poverty.*

commodity markets, it can be anticipated that, over time, there will be a kind of “Darwinism” in the carbon markets in which only the most prepared and best adapted will survive. It can be speculatively anticipated that there will most likely be only a few global carbon credit market hubs going forward, including perhaps Shanghai, New York and a European market.

This is because, in light of what is happening with global markets, **only those markets that manage to raise the critical mass will survive**; that is, they will manage to attract a significant number of carbon credit providers and a significant demand for carbon credits, and thus will form a large and dynamic market.

Some of the determinants of the promotion of the carbon market are:

- (i) Corporate commitments to achieve net-zero emissions (the number of companies tripled, from 500 in 2019 to more than 1,500 in 2021).
- (ii) The consolidation of standards that validate the generation of carbon credits from the voluntary market (Verra, Gold Standard, ACR).
- (iii) The diversification of carbon credit alternatives, with

new niches, such as biodiversity, agriculture and the blue economy.

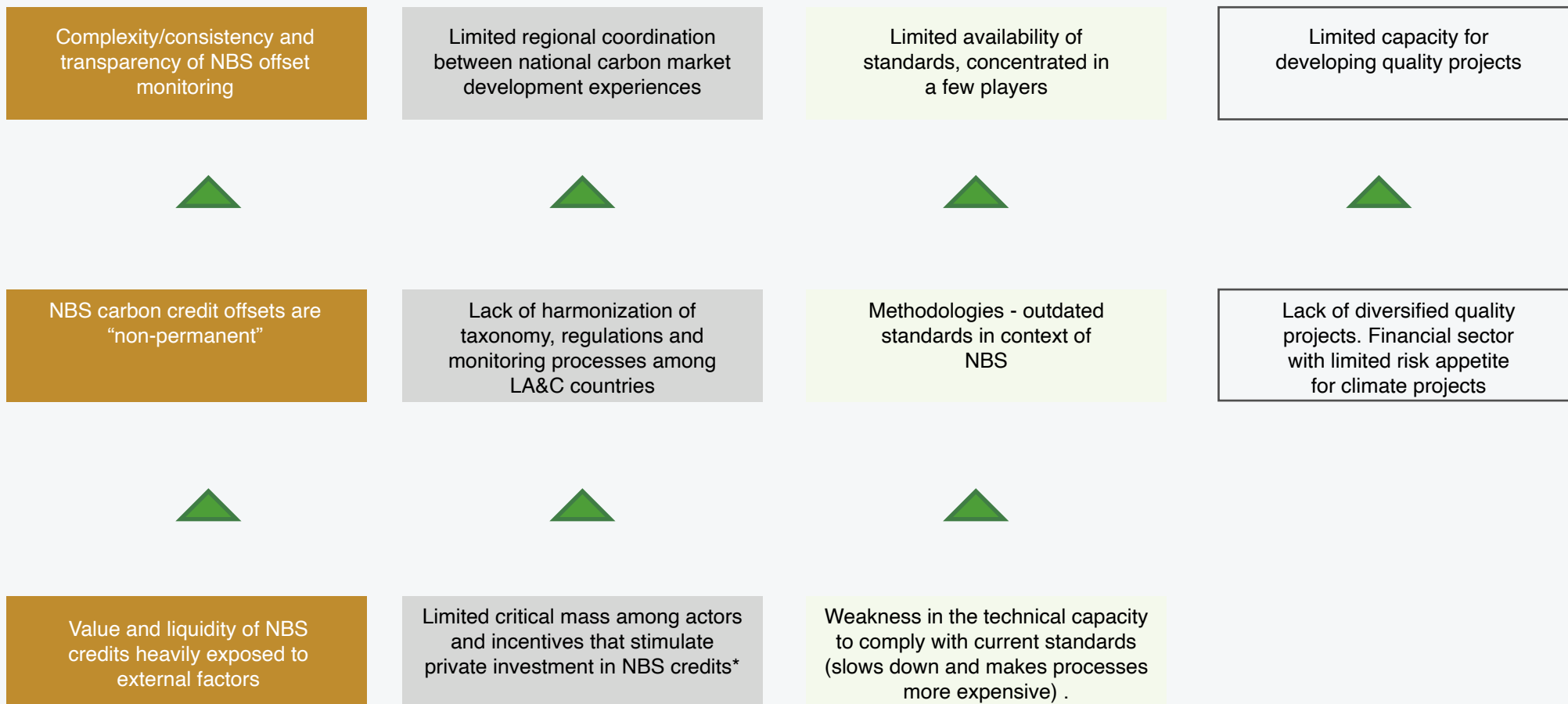
- (iv) The carbon price, which is applied in 27 countries, 4 of which are in Latin America;
- (v) The emissions trading systems implemented in 9 countries, including Mexico;
- (vi) The recent conclusion of Article 6 of the Paris Agreement, which, together with the strengthening of national decarbonization objectives, should generate a significant demand for carbon credits for compensation within the framework of international markets; and
- (vi) Emerging regulations, such as the European Union's Green Deal.

In this context, The objective of the Latin America and the Caribbean Carbon Market Initiative (ILACC) is to promote the global competitiveness of the supply of carbon credits generated in the region, expanding the impacts on job creation, income, development of value chains, technologies, clusters, green business products and the fight against poverty.*

***A carbon credit is a certificate that represents the reduction or removal of one ton of CO2 from the atmosphere. These certificates aim to monetize the climate benefits built into certain projects and provide them with an additional stream of income.**

CHALLENGES

LOW COMPETITIVENESS IN CARBON MARKET IN LATIN AMERICA AND THE CARIBBEAN (LA&C)



* Critical mass is the portion of the market (it can be % of global GDP, % of total population, etc.) that participate in an agreement. For ILACC, it represents the % of credit providers and credit applicants seeking carbon markets in LA&C.



In line with its strategy of supporting shareholder countries and the region in leveraging resources to finance projects that not only add economic value to the region, but also allow it to meet carbon emission reduction goals, CAF – Development Bank of Latin America promotes a program for the strengthening of national carbon markets and the creation of a regional market that positions the region as a protagonist in this new scenario².

From a macro perspective, there are two major challenges for the Latin American and Caribbean (LAC) region to position itself, attract investment and capitalize on its comparative advantages of natural capital, within the framework of the global carbon credit market:

- i) Proactive participation in the normalization of the voluntary and regulated market. It must be recognized that the appetite of the global market for carbon credits and the price of the supply generated in LAC does not depend only on the quantity, variety and quality of each country's supply, but also on the regulatory mechanisms of the main buyer markets, as well as those successful in the United Nations.

These external factors are in the process of analyzing, structuring, and negotiating, and it will be essential for LAC to have mechanisms for the exchange of knowledge, dialogue, and coordination that allow the regional offer of carbon credits to remain legitimate and widely accepted.

- ii) Synergies between the development of national markets and the regional carbon market. It is important to internalize the idea that there is no trade-off between the development of national markets and the regional market. The development of the regional market should contribute to the reduction of transaction costs, attraction of capital and formation of a critical mass, thus being a reflection of the maturity reached by the national markets.



Beyond the confluence of supply and the demand, from ILACC, is sought promote the development of the market, through overcoming barriers and efficient operation, covering aspects such as development capabilities, regulations, incentives, transparency Mechanism, financing and co-financing of projects, distribution of resources, access to markets and other aspects that contribute to successful relationship between suppliers and global credit buyers of carbon generated in LAC.

¹ It is noteworthy that between 2005-2011, CAF executed a support program to strengthen national capacities, as part of its participation in the negotiations associated with the Kyoto Protocol and the Clean Development Mechanism.

Bearing in mind these two macro challenges, it would be necessary to add others which are unique to the region, among which the following stand out:



a) Political economy or short-term political intervention. It is necessary that the need for immediate results be combined with a long-term national and regional strategic vision that can give competitiveness and sustainability to the market.



b) Strengthen the processes promoted at the national level and the formation of subregional markets within the scope of the Pacific Alliance and Mercosur, which can help in the harmonization of regulations, standards and methodologies, but also hinder a regional vision.



c) A third challenge is the need to advance in taxonomy, harmonization of standards and regulations, methodologies, certifications, monitoring services, legal framework and many other complex issues that permeate the progress of a regional market, mainly due to the maturity of some countries in the region relative to others.



d) A fourth challenge is the limited availability of skills and market failures in terms of technical and professional services necessary for the proper functioning of the market.



e) A fifth challenge is the institutionality, transparency and governance of this market.



f) Another challenge is the uneven size of the region's markets, which can lead to mistrust. It is not an exaggeration to risk saying that not even Brazil, with its gigantic credit generation potential, is capable of creating and sustaining an international market for carbon credits. Thus, even this country stands to gain more by negotiating with its neighbors to create a regional market than by attempting a solo attempt.



g) A seventh challenge is to develop adequate and attractive financial and non-financial instruments and mobilize resources to finance projects at the national level at competitive prices and conditions.

CRITICAL FACTORS FOR SUCCESS



From CAF's perspective, there are three critical factors that require immediate attention to promote the development of the regional carbon market:

(i) Infrastructure - By "infrastructure" we refer to an entire service platform that enables, in practice, the correct and adequate functioning of that market. This should include a basic legal framework, monitoring and control and data collection and compilation systems, as well as the full set of services necessary for the carbon market value chain to function, including taxonomy, standards, certifications, legal services, accounting and auditing, custody services, dispute resolution systems, agroforestry and drone and satellite services, engineering and geology services for projects, among many other professional services and consultancies, and financial services to finance projects. That is to say, it is a sophisticated infrastructure that has tangible and intangible components to support the identification of risks and verify the environmental integrity of the projects, in order to allow an adequate setting of credit prices, avoid greenwashing and ensure the predictability of the project market. All of these are critical elements to attract and retain sellers and buyers, especially at a global level, such as multinational companies and investment funds.

(ii) Technical training - This market, still in formation, will require many qualified professionals in the aforementioned areas and also for the conception, development, execution and management of green projects. Generally speaking, these skills are not available in the quantity and degree of specialization that will be required. Without these skilled workers, it will be difficult for a market to gain the trust of players, as well as develop a pipeline of projects at the speed and quality that is required.

(iii) Pipeline of diversified and quality projects - Due to the very nature of this market, to establish itself as an international hub, it will be necessary to attract demand through a timely and diversified supply of conservation, agroforestry, ecological restoration, energy and many other projects. Therefore, in addition to the capacity issues already mentioned, an adequate credit market, insurance and other necessary services will be essential to give efficiency to the project origination, development, execution and monitoring cycle.

THE OPPORTUNITY



The new international competitive scenario offers a historic opportunity for Latin America, perhaps even more important than other boom cycles experienced by the region associated with agribusiness, mining and hydrocarbons

Latin America and the Caribbean will be able to play a very important role in the regulated and voluntary carbon markets, especially given its unique ability to offer green projects and nature-based solutions, at cheaper marginal costs than elsewhere. But to harness all that potential, it will be essential to overcome the identified challenges.

Considering the complexity and high costs involved in these factors, a promising way to position the region on the map of the global market for carbon credits is through a regional integration of national initiatives, with the potential to reach the creation of a regional market, in a way that allows economies of scale and cost reduction, but also an intense pipeline of projects. In the end, small and fragmented markets are not likely to survive. As an alternative and opportunity, the creation of a regional certification could be considered, through the development of a regional certification standard for the emission of carbon credits.

In addition to the direct benefits in terms of employment, income, taxes and investments that a large and well-articulated regional market could generate, there are also important indirect benefits associated with the long value chain of that market. This value chain could even promote or give rise to the creation and strengthening of other regional markets that require similar capabilities and infrastructure, with perhaps an even more important multiplier effect (e.g. renewable energy market, forestry market and climatic investment fund market).

If, on the other hand, carbon credits originating in Latin

America and the Caribbean are traded in New York or Shanghai, for example, part of this direct and indirect benefit, including employment and income, is transferred to those countries. In the Latin American context, there is enormous potential to be explored by the private sector in the carbon credit market, either through offset credits or through new projects under Article 6.4 of the Paris Agreement. The region's competitiveness must be ensured by the credibility, quality and transparency of the region's carbon credits.

Another economic benefit of accelerating the carbon market in the region is allowing companies to comply with environmental regulations to compete in an international context of growing threats stemming from the unilateral imposition of environmental trade barriers and access to concessional and non-concessional resources. This is a very important factor for the competitiveness of agro-exports and is evident, for example, in the EU's Farm to Fork program.

The new international competitive scenario offers a historic opportunity for Latin America, perhaps even more important than other boom cycles experienced by the region associated with agribusiness, mining and hydrocarbons. The difference is that, on this occasion, the work agenda must contemplate the combination of, on the one hand, the conservation and regeneration of natural capital assets and, on the other hand, economic diversification, technological progress and combating poverty as determining factors for established and sustainable growth in the region.

OUR RESPONSE



If the underlying conditions that drive the global demand for carbon credits continue, it will present an opportunity to perfect the current market mechanisms, seeking to articulate and consolidate the different niches, develop and standardize benchmarks, integrate practices that give greater transparency to operations, in addition to reinforcing the insertion of the offer through commercial platforms.

For this, ILACC plans to work through a comprehensive approach in the execution of three components:

- **Component 1 - Regional Political Agenda:** Consists of recognizing that it is not a question of a trade-off between the formation of national markets and the regional market, but of processes that can and need to proceed in parallel. It is therefore necessary to work on an agenda of alignment of converging interests, of education and knowledge about the costs and benefits that combines national efforts with the challenges of forming a regional market. It will therefore be necessary to harmonize and value the expertise developed by countries with advanced programming, in addition to promoting businesses that demonstrate the benefits of a common market and that can attract much more international attention. This will be done through proactive knowledge management, which will include the production of papers, exchange of good practices between teams from ministries, the National Development Bank (NDB) and government agencies, as well as project developers, traders, buyers and associations, seeking to generate a shared vision that can be present in normalization meetings of the voluntary and regulated markets.

Impact indicators are:

- # of topic-related technical roundtables for regional coordination
- And # of technical proposals directed towards the development and integration of markets.
- **Component 2 - Regional Technical Programming:** The purpose of this component is the coordination of a regional technical programming for the development of a roadmap aimed at developing a taxonomy and harmonization of standards and certifications, central elements for this agenda. This task will require a highly coordinated set of activities with teams from different governments and specialists. CAF could offer advice and finance technical cooperation, in addition to playing a proactive role in mobilizing third-party resources. In the future, this same approach could also be applied in the development of financial and non-financial instruments, to explore ways of raising funds to finance projects such as the issuance of green bonds with guarantee backing and technical support for the structuring of CAF and financial allies to use in local projects through local banks.



The objective consists of the generation and dissemination of knowledge that contributes to the acceleration of learning processes and reinforcement of capacities and strengthening of chains.

Impact indicators are:

- Total financial resources mobilized to overcome barriers to market development and integration. (CAF resources and third parties);
- And total technical assistance offered aimed at overcoming barriers to the development and integration of markets (CAF resources and third parties).
- **Component 3 - Knowledge Management:** The objective consists of the generation and dissemination of knowledge that contributes to the acceleration of learning processes and reinforcement of capacities and strengthening of chains. The component would be based on a regional training and capacity building proposal, in the most critical areas associated with the value chain of the carbon market, in such a way that market opportunities are addressed and the most empty spaces are filled, in the extent possible. Here it would be necessary to cooperate with academia, professional training centers, in addition to creating CAF's own MOOC, among others. It would also be important to identify the critical links that are missing from the services for the functioning of the value chain and to promote, with credit instruments and other instruments, service companies and/or the attraction of foreign companies³.

Impact indicators are:

- Regional platform of knowledge for best practices.
- # of technical publications produced under the guidelines of regional priorities.
- # of topic-related regional conferences: development of projects, fulfillment of standards, commercial strategies, funding, among others.
- And # of international conferences for the positioning of the regional offer in the international market.

³ See references www.southpole.com and <https://www.allcot.com>



NEXT STEPS

- Formation of the network of strategic allies of ILACC, to be formed by National Development Banks, national public institutions, as well as market players, such as carbon traders, buyers and associations⁴.
- Prepare a regional diagnosis that results from the analysis of the situation of the participating countries and serves as a basis for the preparation of a regional work program for the period 2022-2026.
- Support the execution of the 2022-2026 regional technical programming through advisory services, financial resources from CAF, and mobilization of third-party resources.
- Mobilize the participation of strategic actors that contribute to the reinforcement of national capacities and the financing of work programming.
- Facilitate access to funding through mechanisms that improve conditions and opportunities, expanding investment from the private sector.
- Create mechanisms for dialogue and cooperation between the countries of the region and between the different actors, public and private, with a view to negotiations at the COP that favor the regional offer of NBS. For this, ILACC will play a key role in holding forums, workshops and conferences.

⁴ Taking into consideration cases such as <https://asocarbono.org> and organizations such as www.ieta.org

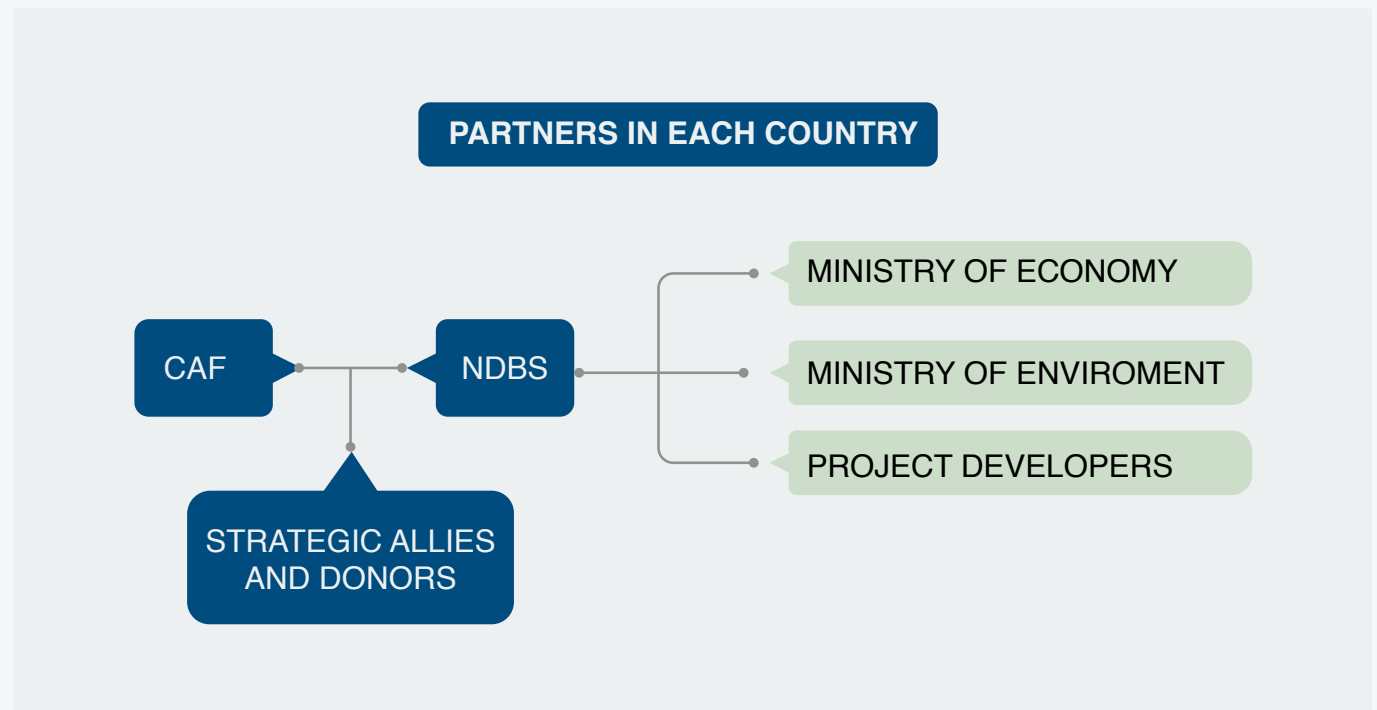
WORK APPROACH



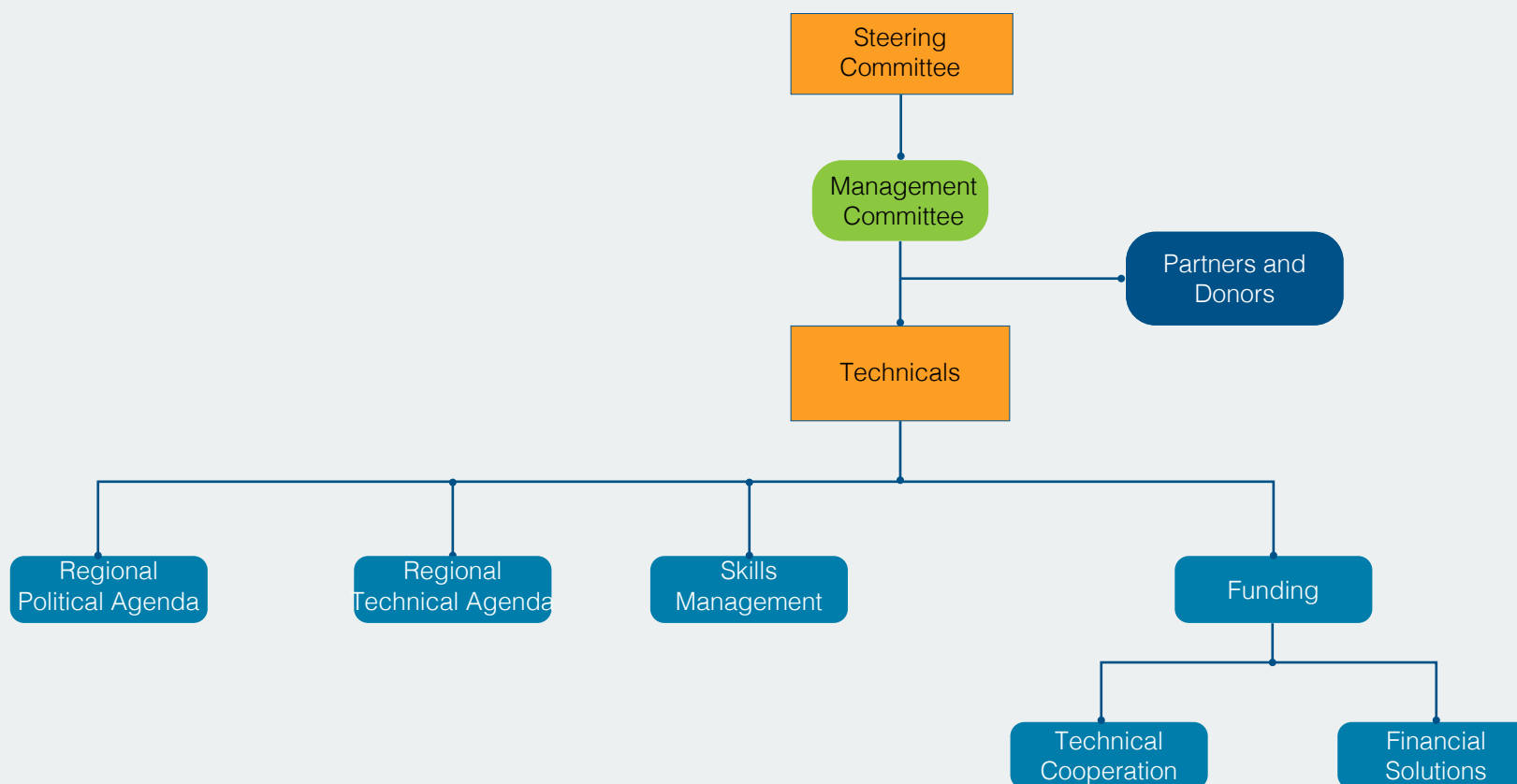
The implementation of ILACC is planned in two stages:

- **Stage 1:** Consists of finalizing the design of the work program. (January - April 2022). The objectives foreseen for this first stage are: (a) incorporate national priorities into the work program; (b) promote a sense of opportunity and a shared strategic vision; (c) approve a short- and medium-term work schedule; (d) assume commitments and responsibilities.

To achieve these objectives, the VPS must articulate a network of partners that participate in ILACC, with the collaboration of the National Development Banks (NDBs).



- **Stage 2:** Consists of the 2022-2026 implementation of the ILACC work schedule. The implementation will have a Steering Committee, whose purpose is to articulate the collaboration between the participating partners, allowing the proper implementation of the initiative, as well as facilitating their participation in Monitoring & Evaluation activities, knowledge management, mobilization of allies and resources. The committee will have CAF as Executive Secretary of ILACC.



ANNEX

ANNEX 1: List of Interviewed Actors

Sector	Organization	Person	Title
MULTILATERAL	UNFCC	Miguel Naranjo	Lead Officer MDL
National Development Bank	BNDES	Gustavo Montezano	Carbon Markets Specialist
National Development Bank	Bancoldex	Javier Díaz	President
National Development Bank	COFIDE	Carlos Linares	President
ACADEMIC	UFRJ/COPPE	Emilio Lebre La Rovere	Director, Climate Center
ACADEMIC	UFRJ/COPPE	Guido Penido	Climate Center
ACADEMIC	UFRJ/COPPE	Carolina da Silva	Climate Center
PRIVATE	South Pole	Carolina Kitchen	Carbon Policy and Financing Specialist
PRIVATE	South Pole	Victor Hugo Escalona	Carbon Pricing Specialist
PRIVATE	South Pole	Luz Adriana Velaszo	Director, Latin America
PRIVATE	South Pole	Lilia Suárez Virviesca	Trade Specialist
PRIVATE	BAM	Maria Alejandra Cantuarias	Director of Carbon Credit Trade and Commerce
PRIVATE	BAM	Alejandra Agurto	Director, Peru
PRIVATE	BAM	Andres Agramonte	CFO
PRIVATE	BAM	Sergio Hanna	Regional Director
PRIVATE	BAM	Eduardo Galindo	Project Manager
PRIVATE	BMV	Clayton Fernandez	Chief Strategy Officer
PRIVATE	BMV	Maria Tereza Umbelino	CEO
PRIVATE	BMV	Todd Chapman	Director, Brazil
PRIVATE	FCS	Pina Gervassi,	Director, Latin America

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- Jorge Arbache – Vice President of the Private Sector
 - Gladis Genua – Director – ggenua@caf.com
 - Federico Vignati – Principal Executive – fvignati@caf.com
 - Nelson Larrea – Principal Executive

ACKNOWLEDGEMENTS

This document was prepared by the VSP and had the review and input of: René Gómez-García (DACA/CAF), Camilo Rojas (DACA/CAF), Emilio Lebre La Rovere IPCCC, Guido Penido (COPPE/UFRJ), Carolina da Silva (COPPE/UFRJ), as well as based on interviews conducted with BAM, BANCOLDEX, BANCOLMEX, BMV, BNDES, COFIDE, FSC, South Pole and UNFCC.

development bank of Latin America - feb 2022



